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Egypt's Impending Financial Crisis: Potential Problems for the United States

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An Intelligence Assessment

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July 1983

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Egypt's Impending Financial Crisis: Potential Problems for the United States [redacted] 25X1

An Intelligence Assessment

This paper was prepared by [redacted] 25X1
Egypt-Sudan Branch, Office of Near East–South Asia Analysis. It was coordinated with the Directorate of Operations. [redacted] 25X1

Comments and queries are welcome and may be directed to the Chief, Arab-Israeli Division, NESA,
[redacted] 25X1

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Egypt's Impending Financial Crisis: Potential Problems for the United States [redacted] 25X1

Key Judgments

Information available as of 11 June 1983 was used in this report.

Egypt is edging toward a financial crisis that runs the risk of forcing the government to make tough domestic austerity decisions, creating political problems for President Hosni Mubarak and perhaps straining relations between Cairo and Washington. [redacted] 25X1

Egypt already is encountering some problems servicing its debts, and lower oil earnings will cause foreign exchange difficulties to worsen in the months ahead. Although Egypt has taken several modest steps to deal with its foreign payments problems, additional and far-reaching measures almost certainly will be necessary either to avoid a full-blown crisis or to cope with a crisis after it occurs. There is no consensus on what actions are necessary, however, and we believe Egypt will put off bold reforms until foreign financial problems force the government's hand. [redacted] 25X1

The reforms implemented so far have not caused major problems, but the public mood has deteriorated in 1983 as inflation has picked up. This has sharpened the conflicting pressures on the government both to maintain stability and to take potentially risky actions to moderate the negative impact of reduced oil earnings. [redacted] 25X1

The situation will deteriorate rapidly if oil prices again start falling, if there are disruptions in short-term foreign commercial financing, or if food import prices increase sharply. The likelihood of these events occurring is small, but any one of them would be a major setback for Egypt. Even without a setback, Egypt could drift into a debt crisis in late 1983 or 1984 by failing to adjust adequately to the oil price decline. [redacted] 25X1

A foreign debt crisis would have serious domestic as well as foreign repercussions. Past foreign financial crises are associated in Egypt with traumatic political events such as the bread price riots of January 1977 that shook the Sadat regime. In recent months there has been increased public grumbling about economic hardships. Government austerity measures in response to a foreign payments crisis would provide an effective issue for opponents of the regime to exploit. [redacted] 25X1

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A debt crisis would complicate relations with the United States, Egypt's largest creditor. Cairo already has tentatively explored the possibility of debt relief for payments due on US Foreign Military Sales credits. If Egypt cannot service its debts to the United States, we believe that Egyptian officials will expect special treatment commensurate with the close political relationship both Washington and Cairo have sought to construct. Cairo will draw parallels to US aid for Israel—which the Egyptians believe should be roughly equal to that given Egypt—to buttress its case. In addition, there is a widespread belief in Egypt that Washington advocates reduced subsidies and domestic price hikes, making it likely that any domestic backlash caused by new economic austerity measures will be blamed at least partly on the United States. 25X1

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Egypt's Impending Financial Crisis: Potential Problems for the United States

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During the late 1970s Egypt enjoyed a period of rapid economic growth and an improved foreign payments situation. These favorable developments were spurred by large inflows of foreign assistance (especially from the United States); sharply rising foreign earnings—from oil and worker remittances in particular; and policies that stimulated private-sector activity. As a result, Egypt was able to underwrite increasingly expensive consumer subsidies and price controls to shelter low- and middle-income consumers. 25X1

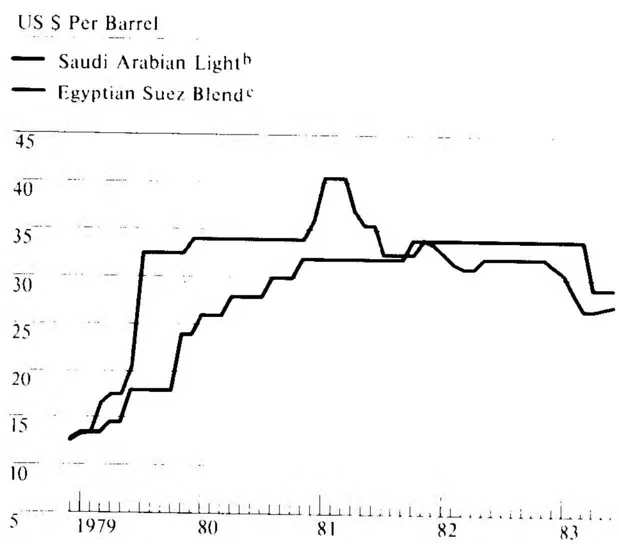
This era of rising prosperity is coming to an end, and the country's longstanding problems are again closing in on Egypt's policymakers. Economic growth has slowed, and the foreign payments situation is deteriorating. Rapid population growth, inadequate public services and housing, and sharpened income disparities are challenging the ingenuity of the government. The public, moreover, is still waiting for the economic dividend it expected from peace with Israel and from close relations with Washington 25X1

Recent Performance

Egypt has weathered the soft oil market and the global recession better than most developing countries. Policy adjustments and the fortuitous decline in key agricultural import prices held the current account deficit in 1982 to $2.4 billion, according to preliminary data from the Central Bank of Egypt. The deficit was only $300 million larger than in 1981 and fell far short of the $3 billion or more current account deficit predicted by the International Monetary Fund and other observers. (Military trade and payments are excluded from Central Bank data and are similarly excluded from our 1983 estimates.) 25X1

Export earnings rose 5 percent in 1982 to $4.2 billion, according to Central Bank data. Oil earnings—70 percent of exports—increased by $100 million over 1981 to $2.9 billion. This small increase in the face of falling oil prices reflects efforts to expand sales slightly and possibly a one-time change in credit terms. In

Figure 1
Egyptian and Saudi Arabian Oil Prices, 1979-83[a]



[a] For comparison, Egyptian oil prices in 1981 and 1982 have been adjusted downward to approximate the 30-day credit terms of Saudi Arabian Light. This adjustment is $0.50 per barrel for 60-day credits and $1.00 per barrel for 90-day credits. Data are for the end of the month for the first plot and the first of each month for all others.

[b] 34° API, 1.7% sulpher.

[c] 34° API, 1.4% sulpher.

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April 1981 terms for Egyptian oil sales were changed from 30-day credits to 60-day credits, a move that apparently pushed most oil payments back a month. As a result, 1981 oil earnings probably reflect only 11 months of sales, while 1982 earnings are for a full 12 months. Even allowing for this change, oil earnings in 1982 held up remarkably well, in part because Egypt adjusted prices downward five times during the year to ensure sales (see figure 1) and oil production increased to a historic high of 700,000 b/d in the fourth quarter of 1982. 25X1

Service earnings rebounded in 1982 after a small decline in 1981. Preliminary Central Bank data show remittances from the estimated 1.7 million Egyptian workers abroad were up $100 million in 1982 to $2.3 billion, halting the large decline in 1981. Official remittances fluctuate according to government foreign exchange and import policies. We believe that recorded remittances increased sharply in the second half of 1982 because public-sector banks began paying the higher free market exchange rate for worker remittances, causing a greater share of the remittances to flow into official channels. 25X1

Suez Canal revenues increased 7 percent to nearly $1 billion because of increased traffic (a 4.5-percent increase in transits) and higher tolls. Tourist earnings in official channels hit $700 million compared to $600 million in 1981 but failed to achieve the even higher gains anticipated. The number of nights spent in Egypt by tourists in 1982 declined 5 percent compared with the previous year, probably because of the fighting in Lebanon that discouraged travel to the area and the recession in the West. 25X1

During the year, the value of imported goods and services increased only slightly more than the rise in foreign earnings. According to preliminary Central Bank data, imports rose 6 percent to $9.3 billion, the smallest nominal increase since 1977. Egypt benefited from falling world commodity prices that kept pace with or exceeded the fall in petroleum prices during the year (see figure 2). Foodgrains and sugar comprise nearly a fourth of Egypt's total imports; wheat prices declined 9 percent in 1982, and sugar prices fell 50 percent. 25X1

Government actions to restrict imports also helped. Although an index of import volume does not exist, we suspect real imports increased less than in previous years:

- An Import Rationalization Committee was established that prohibited some luxury imports and limited imports of items produced domestically.
- The Central Bank of Egypt selectively tightened domestic credit controls to reduce demand for "nonessential" imports.

Egyptian Exchange Rates

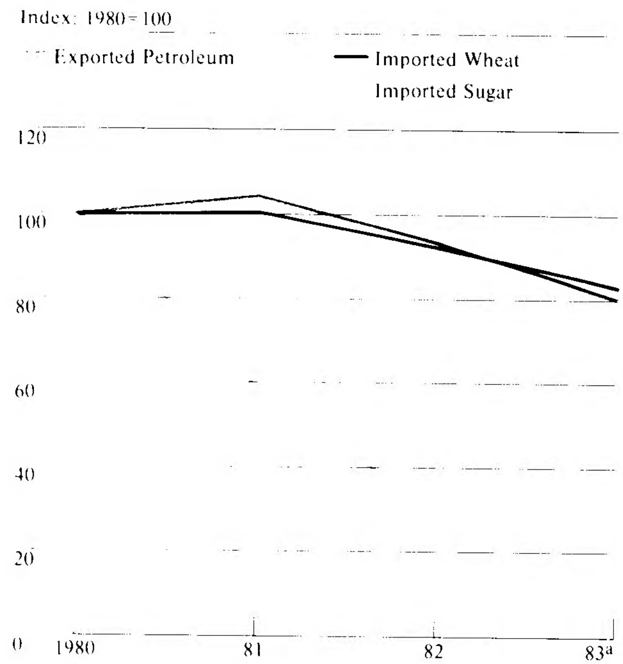
Egypt has a complicated multiple exchange rate system:

- ***Official exchange rate of* £E *0.70 = $1.00.*** *This rate, last changed in January 1979, is used for public-sector earnings—such as petroleum exports and Suez Canal receipts—and for government imports of basic commodities and other approved transactions. The official rate essentially is an accounting rate for foreign exchange transactions within the Egyptian Government.*

- ***Official "incentive" exchange rate of* £E *0.84 = $1.00.*** *This rate was set in 1981 to enable Egypt's four public-sector banks to be more competitive with the free market in the purchase of worker remittances and tourist dollars. Prior to the establishment of this rate, public-sector banks were required to pay the official exchange rate and thus were uncompetitive. Depending on the availability of funds, public-sector firms have access to foreign exchange at the official incentive exchange rate for payments abroad.*

- ***"Own" exchange rate currently at* £E *1.10 = $1.00.*** *This free market rate varies daily, and transactions are made through a group of private traders. Workers abroad and tourists provide most of the foreign exchange for this market. Although originally set up to meet demand for foreign exchange from the private sector, to encourage remittances, and to eliminate the "black market" exchange rate, this market has increasingly been used by public-sector firms and banks because of inadequate foreign exchange in official channels. The term own exchange developed in the mid-1970s when the Sadat government acknowledged the positive economic role a free market exchange rate could play to enable the private sector to import goods using their "own" foreign exchange rather than foreign exchange controlled in government channels.* 25X1

Figure 2
Egypt: Key Export and Import Prices, 1980-83



[a] Projected.

[redacted]

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- Access by public-sector firms to low-priced foreign exchange in official channels was restricted, forcing them into the free market, where higher prices probably limited demand.
- Private-sector importers faced increased administrative red tape, particularly customs regulations, that we believe was intended to impede foreign purchases. [redacted]

Egypt covered its 1982 current account deficit of $2.4 billion through concessional and commercial borrowing. Egypt's official nongold foreign exchange reserves started and ended 1982 at about $700 million or less than one month of import coverage. [redacted] another $700 million has been deposited in the alternative energy fund, but this is legally earmarked to help pay for nuclear power projects. Economic aid disbursements of $900 million from the United States were the largest single source of foreign assistance and covered one-third of the deficit. The Central Bank of Egypt arranged a $200 million syndicated Eurodollar loan, and public-sector banks obtained at least another $75 million in medium-term loans. Suppliers' credits and other commercial credits of one year or less increased by an estimated $600 million, down from the $900 million increase in 1981. While lenders continued to view short-term loans to Egypt favorably, many banks were reluctant to expand their long-term exposure in line with the general global slowdown in lending to Third World countries. [redacted] 25X1

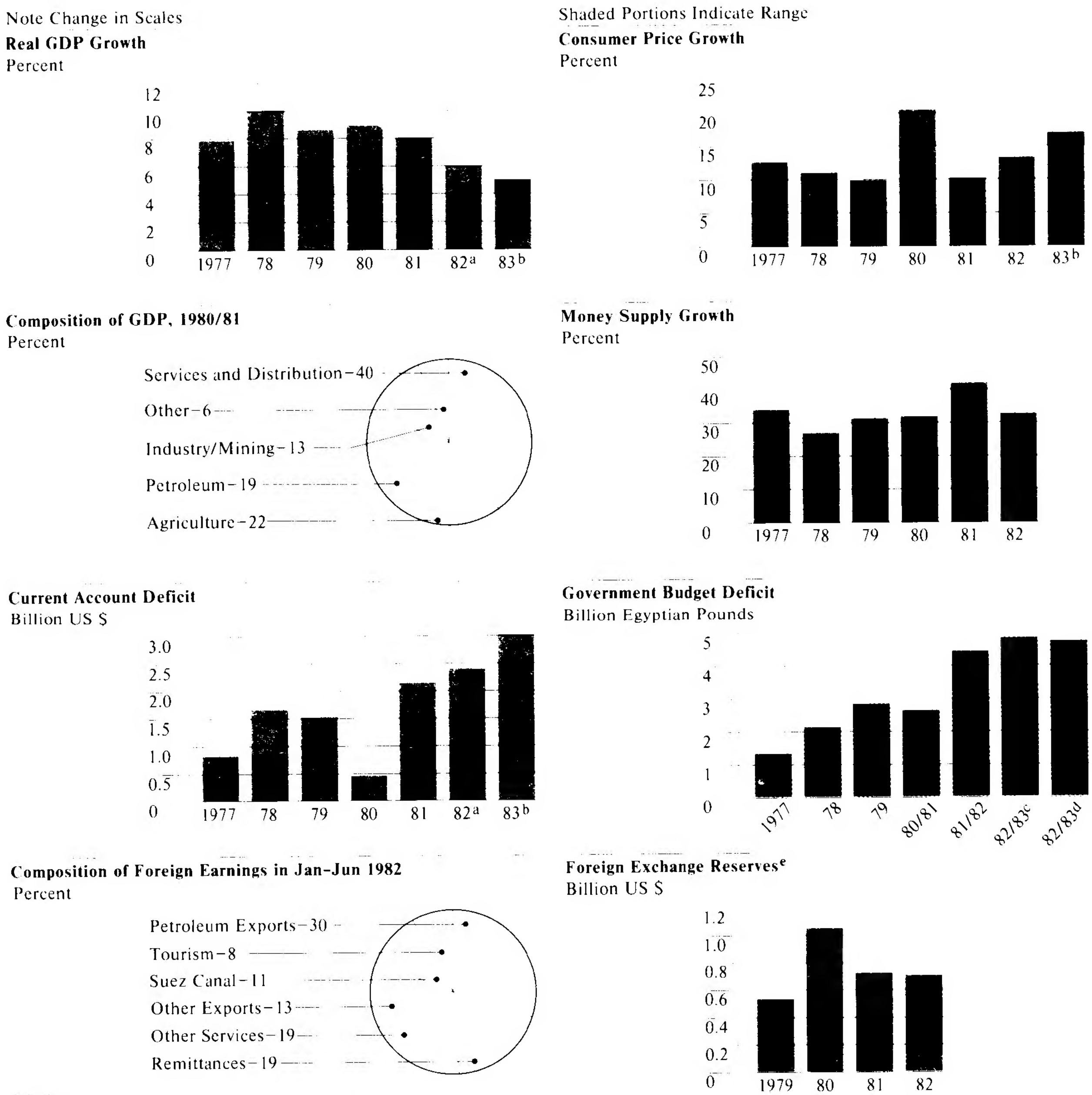
Overall economic growth in 1982 probably slowed to around 6 percent because of the austerity brought about by the tighter foreign exchange situation. (Official data are not yet available.) Although this was a favorable performance compared to most developing countries, it was lower than the 8- to 9-percent levels of recent years. [redacted] 25X1

Inflation edged up to 13.3 percent in 1982 compared to 10.2 percent in 1981, according to data compiled by the US Embassy. Price increases were fueled by rapid monetary expansion that in turn was generated by government deficits equivalent to 20 percent of GDP. We believe this is a reasonably accurate reflection of the inflation rate faced by many middle class urban Egyptians with some discretionary income to spend. This includes such politically important groups as the military and public-sector workers. Low-income consumers probably face a lower inflation rate, since most of their income is spent on commodities that are protected by extensive government price controls and subsidies. Upper income consumers who spend a greater proportion of their income on goods not under price controls probably cope with an annual inflation rate of 20 to 25 percent or more. [redacted] 25X1 25X1 25X1

Problems Increase in 1983

Declining world oil prices were a key concern of the Egyptian Government in the early months of 1983. In response to market pressures and in an effort to maintain sales, oil prices were cut in each of the first 25X1 25X1

Figure 3
Egypt: Economic Indicators



[a] Estimated.
[b] Projected.
[c] Initial estimate.
[d] IMF estimate.
[e] End of period. Excluding gold.

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three months of 1983 by a total of $4.50 per barrel. As the oil market firmed in the spring, however, Egypt was able to raise prices 25 cents a barrel at the start of May and June. Nevertheless, the government apparently is attempting to prepare the public for further economic retrenchment and publicly acknowledged that oil earnings would be $250 million less than the original target of $2.7 billion for the Egyptian fiscal year ending 30 June. Egyptian officials have conceded privately to US Embassy officials that revenues will be down $300-400 million or more. 25X1

Table 1
Egypt: Current Account Balance

Billion US $

	1980	1981	1982 [a]	1983 [b]
Trade balance	−3.7	−4.8	−5.1	−6.0
Exports	3.9	4.0	4.2	3.5
Oil	2.5	2.8	2.9	2.1
Nonoil	1.3	1.2	1.3	1.4
Imports	7.6	8.8	9.3	9.5
Net services	3.2	2.7	2.7	2.9
Receipts	5.3	5.1	5.8	5.9
Remittances	2.7	2.2	2.3	2.4
Suez Canal	0.7	0.9	1.0	1.0
Tourism	0.8	0.6	0.7	0.7
Other	1.2	1.4	1.8	1.8
Payments	2.2	2.4	3.1	3.0
Unrequited transfers	0.1	0.1	NEGL	0.1
Current account balance	**−0.5**	**−2.1**	**−2.4**	**−3.0**

[a] Preliminary Central Bank of Egypt data.
[b] Projected. Assumes oil prices remain at 1 June level through end of year 1983.

Note: Figures may not add, due to rounding.

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A tight foreign exchange situation persisted in the first months of 1983. It probably will worsen in the months ahead as the impact of lower earnings is felt, but we believe the government should be able to muddle through 1983, barring new setbacks. We project that Egypt's current account deficit in 1983 will deteriorate to $3 billion from the $2.4 billion deficit last year. This projection assumes:

- Oil prices remain at 1 June levels—causing prices for the year to be 14 percent lower than the 1982 average and earnings to fall to about $2.1 billion.
- Egypt continues existing limits on nonessential imports.
- Wheat and sugar prices continue to fall, and the dollar value of overall OECD export prices remains constant.
- Worker remittances grow slightly, while earnings from the Suez Canal and tourism remain at about 1982 levels. 25X1

Financing a $3 billion deficit in 1983 will not be easy, however, and the government may be forced to take direct action to prevent this large deficit from occurring. Egypt has little room to draw down its minimal foreign exchange reserves, and access to the $700 million in the alternative energy fund is blocked by legal constraints. Foreign aid disbursements are not likely to increase much over last year. Most US and other Western banks are increasingly wary of providing balance-of-payments loans to Egypt, although Arab-owned banks appear willing to pick up some of the slack, according to a survey by the US Embassy earlier this year. 25X1

The government has had to adjust further its foreign exchange rate policies in response to the tight situation. The government has switched more transactions from the official incentive exchange rate to the free market rate. According to Minister of Economy al-Sa'id, the four public-sector banks have become the largest buyers of foreign exchange in the free market and account for 75 percent of demand. The public-sector banks have created a near monopsonistic situation (one buyer-many sellers) by starting to coordinate their purchases of foreign exchange from dealers. According to al-Sa'id, the banks' actions were responsible for driving the free market exchange rate from £E 1.15 = $1.00 to £E 1.10 = $1.00. 25X1

We believe economic growth will continue to slow because of the oil price declines and will be in the range of 4 to 5 percent in 1983. While some senior economic officials have acknowledged to US Embassy officers that Egypt will not be able to sustain the

rapid growth of recent years, this view is not shared throughout the government. Senior officials at the Ministry of Planning continue to assert that Egypt will meet the 8-percent annual real growth target contained in the five-year plan (July 1982 to June 1987). 25X1

Inflation is running higher in 1983 than last year's 13.3 percent and will probably end in the 15- to 17-percent range for the year. Prices in the first four months of 1983 were 15.3 percent higher than the same period a year earlier. April, always a bad month for prices because of seasonal produce shortages, witnessed the single largest monthly jump in prices (4.7 percent over March) since Mubarak became President in late 1981 (see figure 4). Although prices declined by 1.4 percent in May, we expect they will remain under pressure from continuing large budget deficits and foreign exchange shortages. 25X1

Day-to-day economic problems, aggravated by adverse developments such as April's price increases, remain a potential catalyst for politically troublesome civil unrest. The difficulties of life in Cairo—frequent sewer and water main breaks and traffic jams—have worsened in recent months and soured the public mood, according to the US Embassy. Grumbling at all levels of society over economic issues appears to be on the rise. Mubarak has attempted to educate Egyptians about the hard economic facts of life, but his exhortations for sacrifice and hard work apparently have not been well received by the Egyptian public. On the other hand, in past years the public mood has improved after April when prices rise less rapidly or occasionally even decline for a month or so as they did in May. Spirits also are lifted during the Muslim month of Ramadan (which started this year on 11 June) when the government greatly increases food supplies. Should price increases accelerate, however, or if food supplies are constrained, the government will have its hands full keeping discontent at manageable levels.

Figure 4
Egypt: Consumer Price Index, 1981-83

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Policy Changes to Date

The government so far has only cautiously addressed those reforms needed to deal with longstanding economic problems in order to avoid policy shifts that could result in near-term domestic turmoil. Maintaining low food and energy prices—bread at 5 cents a pound and domestic petroleum prices averaging 20 percent of world market values—are prime examples of politically popular policies that harm economic development prospects. Among other things, such policies stimulate consumption while enlarging domestic budget and foreign current account deficits. 25X1

Top economic officials are aware that pervasive cost/price distortions skew investment decisions, encourage excessive consumption, and discourage productivity improvements. For example, Deputy Prime Minister and Petroleum Minister Hilal recently estimated the cost to the government of low domestic petroleum 25X1

Principal Economic Officials

***Prime Minister Muhi al-Din**, Mubarak's prinicipal domestic adviser, is extremely wary of new economic policies, particularly price hikes, that might upset domestic stability. The numerous positions he has held in Egyptian cabinets since 1974 reflect his political skills and his "don't-rock-the-boat" attitude.* [redacted]

***Deputy Prime Minister and Petroleum Minister Hilal** has managed the oil sector since the early 1970s and has been in the cabinet since 1974. He is keenly aware of the economic costs of cheap domestic energy but is either unwilling or unable to press for price hikes because of strong political opposition.* [redacted]

***Planning Minister al-Ganzuri** has informed US officials that Egypt will reduce subsidies over time but argues that the government cannot announce its intentions in advance. Ganzuri is sticking to the argument—unrealistic, in our view—that the oil price decline will not derail the investment and economic growth targets of the five-year plan (1982/83-1986/87).* [redacted]

***Finance Minister al-Hamid** has the task of managing the government budget. He supports selective price increases to reduce the government subsidy bill but has told US officials that he believes the IMF has been "too tough" on Egypt and that major price and wage reforms will take more than five years to implement.* [redacted]

***Minister of Economy and Foreign Trade al-Sa'id** claims that Egypt agrees with US ideas on economic reforms but disagrees with Washington over the suggested pace of such reforms. Unlike Planning Minister al-Ganzuri, al-Sa'id expects lower oil prices to result in sharply slower economic growth.* [redacted] 25X1

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***Minister of International Investment and Cooperation Shindi** has told US officials that Egypt is committed to gradual economic reforms but argues that the United States wants them implemented too rapidly. He would like the United States to provide economic aid on a cash flow basis such as it does for Israel. If that is not possible, he would prefer an increased share of US aid as quick disbursing commodity assistance rather than project financing because such aid is more useful in meeting foreign exchange shortages.* [redacted] 25X1 25X1

***Minister of Supply Shatla**, appointed in March 1983, sits at the top of the government's commodity distribution and subsidy system. He has pledged to expand the number of distribution outlets to provide better coverage in outlying areas and has promised that subsidized commodities will remain available to those in need. To reduce government spending, he has urged Egyptians to voluntarily minimize waste.* [redacted] 25X1

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prices at $2.7 billion a year by comparing the value of petroleum sales in Egypt ($900 million) with the value of this petroleum on the world market ($3.6 billion). The major price adjustments needed to redress these problems, however, are judged by Egyptian leaders to be politically unacceptable, particularly by cabinet members who have little economic responsibility and are more concerned with domestic stability than with economic progress. [redacted]

There is widespread agreement among Egyptians that the government must "do something," but there is no consensus on the direction the government should take. Mubarak, for his part, has not defined a new strategy to deal with Egypt's economic problems. His reliance on staff advice has proved ineffective, since Egyptian politicians, economists, and bureaucrats cannot agree on the goals and policies Egypt should pursue. [redacted] 25X1 25X1 Some groups advocate a return to a more centrally controlled economy 25X1

like that pursued by Nasir. Other economists and businessmen, however, are pushing for increased freedom for the private sector.

Lacking agreement to undertake major reforms, the government is pursuing an incremental approach that attempts to minimize political fallout:

- Consumer electricity prices were hiked 5 to 20 percent in April 1982 and April 1983.
- Electricity rates increased by 50 to 60 percent for high-voltage industrial users in the fall of 1982, and low-voltage industrial consumers were charged 15 percent more in the spring of 1983.
- Public-sector wages were increased in May 1982 by £E 4 per worker per month, far less than raises granted by Sadat, and a 10-day pay bonus was provided only in May, rather than for both May and October as was the custom under Sadat.
- An increase in the number of items subject to the consumption tax was coupled with tax rate hikes of 5 to 100 percent to increase government revenues and discourage luxury consumption.
- Tax collection efforts were stepped up in the summer of 1982.

With memories of the riots over bread price hikes in January 1977 still strong, even these gradual changes have been made reluctantly and with little public fanfare. One senior economic official has informed US Embassy officials that the cabinet was "100 percent" against the April 1982 electricity price hikes when they were first proposed. When further rate hikes were suggested to the cabinet this year, "only" 70 percent of the ministers initially opposed the proposal. Public reaction to the price hikes has been closely monitored by Egypt's domestic security services; so far there has been grumbling but no disturbances.

Although these minor reforms have not caused major problems, the public mood has deteriorated in 1983 as inflation has picked up. This has sharpened the conflicting pressures on the government both to maintain stability and to take potentially risky actions to actions to moderate the negative impact of reduced oil earnings. We believe the government is slackening its reform efforts despite official arguments that the long-term reform effort is on track: 25X1

- Public-sector wage bonuses of 15 days' pay announced by Mubarak in his 1983 May Day speech exceed the 10-day bonuses given in previous years.
- The government this spring postponed, to an unspecified future date, the scheduled issuing of new ration cards on 1 July that were touted as part of an effort to begin reducing the large government subsidy bill. 25X1

We believe Egypt will remain unwilling to take bold reforms until it faces a much more serious foreign payments situation. Even then, we suspect it will steadfastly avoid measures that could cause turmoil in Cairo. Nonetheless, the limited reforms taken so far, like the electricity rate hikes since 1982, will be used to try to persuade aid donors, particularly the United States, that Cairo is doing its best to deal with longer term problems. 25X1

Possible Foreign Debt Crisis

Although Egypt is not yet on the verge of a major debt crisis, foreign bankers and the IMF representative in Cairo agree that Egypt bears close watching. Cash flow problems like those that caused late payments to the United States for FMS credits this spring are likely to reoccur later this year. We believe that Egypt's frequent tardiness in making debt payments is due not only to the tight foreign exchange situation but also to inadequate recordkeeping and slow disbursement procedures. 25X1 25X1

We believe there are several possible developments that would cause the situation to worsen rapidly in the near term: 25X1

- *Additional oil price declines.* We estimate Egypt stands to lose about $125 million in oil earnings for each $1.00 per barrel decline in the price of oil. Any additional drop in oil prices probably would begin to affect earnings from worker remittances and the Suez Canal.

- *Sharply increased agricultural import prices.* Egypt's import bill would increase considerably if agricultural prices sharply reverse their recent trends.

- *Foreign lender crisis.* Egypt depends on foreign banks to roll over short-term credits. A sharp decline in short-term lines of credit, whether stemming from a loss of confidence in Egypt's ability to repay in particular or from Third World debt problems in general, would pose major liquidity problems for Egypt. [redacted]

Although these events are unlikely to occur in the near term, Egypt, nonetheless, could drift into a debt crisis in late 1983 or in 1984 simply by failing to deal effectively with its existing foreign exchange problems. Regardless of how a debt crisis arises, it will almost certainly produce domestic political strains. Foreign debt problems in the past are blamed for such wide-ranging events as the ascendancy of British control over Egypt in the 19th century to the January 1977 bread riots that shook the Sadat regime. In both cases, Egypt was popularly believed to have lost a degree of independence and to have been forced by foreign creditors to make decisions. Austerity measures stemming from foreign debt problems would heighten public criticism of the gap between rich and poor. Many Egyptians believe this income disparity stems, in part, from corruption at high levels of government and business.[1] [redacted]

Arab Aid

Although Egypt will look first to the United States for help should a foreign debt crisis occur, Cairo will also turn to the oil-rich Arab states and, as a last resort, the IMF for financial assistance. Since the peace treaty with Israel, Egypt's official financial relationships with the other Arab states have been limited primarily to the sale of weapons to Iraq, which are funded by Saudi Arabia and other Gulf states. [redacted] Saudi Arabia and Kuwait also have continued to roll over the repayment of about $2 billion "on deposit" with the Central Bank of Egypt for the past several years. In any case, Egypt lacks the funds to repay these deposits. [redacted] 25X1

[redacted]

Egypt has active political links with most Arab states, but the lack of full diplomatic relations and Egypt's absence from the Arab League—the forum that approved many large aid flows in the past—are impediments to new official aid flows. Cairo is refusing the political conditions—renunciation of the Camp David accords and the peace treaty with Israel—that some Arab states are demanding as a precondition for Egypt's reentry into Arab ranks. Even if full political relations are restored, major aid relationships with the oil-rich Arab states probably could not be reestablished quickly or easily. These states have their own problems caused by reduced oil earnings. Some of them already have been tardy in aid disbursements to Jordan, and they are trying to reduce their disbursements, although primarily to countries outside the Arab world. Nonetheless, it is possible that some oil-rich Arab states, for political reasons, may provide some discreet financial aid to Egypt in the coming months. [redacted] 25X1

The IMF

Egypt's relations with the International Monetary Fund have not been close. The Egyptians thus far have not needed an IMF loan and have not been particularly open in their dealings with the Fund. The IMF has made clear to the Egyptian Government that it will have to make major policy changes to gain access to IMF resources, changes the government is reluctant to make. For its part, the IMF has taken a dim view of Egyptian economic policies. Because the IMF has made no recent loans to Egypt, the Fund may close its office in Cairo this summer when the current representative's two-year tour is over. [redacted]

The IMF potentially could provide major financing to help Egypt through a payments crisis. Egypt could borrow up to 240 percent of its IMF quota, about $900 million—100 percent of quota under a Compensatory Finance Facility based on lower prices for its

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oil exports and 140 percent of quota under a three-year Extended Fund Facility. Additional IMF resources could be borrowed under standby agreements or if grain prices increase under the cereal-import facility.

The unwillingness of the Egyptian Government to undertake major economic reforms and its reluctance to improve its resource management have been the central factors behind Cairo's problems with the IMF. Like most LDC governments, senior Egyptian policymakers believe that the IMF is pushing measures that would be politically unwise. Finance Minister al-Hamid recently told a visiting US official that the IMF has an overly rigid and theoretical view of economics. The Egyptian leadership is highly sensitive to the appearance of foreign control over economic policies and to the domestic political fallout that could result from acceptance of an IMF reform package.

Implications for the United States

Postponement of politically sensitive economic reforms, although ultimately hazardous to economic progress and possibly a cause of instability in the long run, has provided the domestic stability that has allowed the Egyptian Government to pursue foreign policy goals that often parallel those of the United States. Cairo's reluctance to pursue reforms also has shielded the US image in Egypt. Any domestic backlash caused by economic reforms will be blamed at least partly on the United States. Efforts by the United States to encourage economic reforms have resulted in a widespread Egyptian public belief that Washington is pushing the government to reduce subsidies and hike domestic prices.

Should the tight foreign payments situation develop into a foreign debt crisis, relations with the United States could be strained. Cairo will look to the US Government, its largest creditor, for relief and has already tentatively explored the possibility of postponing payments due on FMS credits. Debt payments to the US Government will be about $500 million this year, will rise to slightly more than $600 million in 1984, and will amount to over $700 million in 1985. These large increases stem from growing disbursements under the FMS program.

The procedures used by the US Government to deal with countries unable to service their debts would, in Cairo's view, directly contradict the special political relationship that it believes it has established with Washington. US debt relief procedures require: 25X1

- The debtor country to be in default or in danger of imminent default.
- All official creditors to meet, usually under the auspices of the Paris Club, and reschedule official debts together.
- An adjustment program, typically under the IMF, that will move the country's economic policies in a direction aimed at eliminating the source of the debt problem. 25X1

If these procedures are applied to Egypt, as they have been to other debtor countries, Cairo will believe that the United States is not treating it like a special partner. Senior Egyptian economic officials already 25X1 have used Egypt's special relationship to explore the possibility of relief from interest payments due on US FMS credits. Particularly galling to the Egyptians would be the requirement by the United States that Egypt seek an IMF adjustment program, thereby forcing Cairo to improve relations with the Fund regardless of the conditions involved. If this occurs, we believe US-Egyptian political and strategic relations will suffer as the two countries become increasingly involved in debt and payments issues at the expense of other concerns. 25X1

A foreign debt crisis and the specter of foreigners dictating Egyptian economic policies would give opposition political parties a potent issue against President Mubarak. For example, a recent issue of the opposition newspaper *Al-Shaab* claimed that the Egyptian Government has not refused US requests to end 25X1 subsidies but is merely implementing changes slowly to avoid the wrath of the poor. The US requirement for Egypt to go to the IMF and the Paris Club would provide regime opponents with additional ammunition against Mubarak. Even Egyptians who have steadfastly supported close ties with the United States probably would find it difficult to understand Washington's debt relief procedures and in any event would

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criticize them as insensitive to Egypt's domestic political situation. The good will that has been generated through past economic and military aid might erode under the pressures of a debt problem. 25X1

A debt crisis would intensify Egyptian efforts to achieve aid parity with Israel, such as cash transfers of economic aid and greater forgiveness of future military assistance. Mubarak and many other Egyptians have told US officials that they believe that such parity was promised to the late President Sadat. Furthermore, the Egyptians believe they have been more supportive than Israel of US interests in the Middle East. In the context of continued US economic aid to Israel after its invasion of Lebanon, Prime Minister Muhi al-Din's jocular aside to a visiting US official last winter, suggesting that Egypt might receive cash transfer aid if it invaded Libya, reflects Egyptian resentment over perceived unequal treatment. 25X1

Although it is possible to argue that a debt crisis will force Egypt to move closer to the United States as it seeks softer aid terms or US help with the IMF, we believe this judgment does not adequately reflect Egypt's deep sensitivity to the appearance of foreign domination. Even if Cairo's foreign payments problems worsen, we believe Egyptian officials will remain extremely wary of actions that suggested Egypt was selling its national honor for needed US dollars. 25X1

Appendix

Egypt's Foreign Debts

The Egyptian Government probably does not maintain an accurate accounting of all foreign debts, and this lack of precise information will complicate efforts to deal with future debt problems. Even the total size of the debt is uncertain. In recent months, high-ranking Egyptian officials have made contradictory statements about the magnitude of the problem.

Planning Minister al-Ganzuri told the People's Assembly in January 1983 that Egypt's civilian foreign debts totaled Egyptian pounds (£E) 13 billion. This corresponds to the debt data for 30 June 1982 included in the current five-year plan. Subsequently, Deputy Minister of Economy al-Banna informed a US Embassy official that the £E 13 billion figure contained "all official obligations" including military debt. Al-Banna cautioned, however, that it would be difficult to convert this figure into US dollars because Egyptian data were calculated at a variety of exchange rates, including the official exchange rate of $1.00 = £E 0.70; the official "incentive" exchange rate of $1.00 = £E 0.84; and, for old debts to the Soviet Union and Eastern Europe, the old official exchange rate of $1.00 = £E 0.40. Although al-Banna was unable to provide an appropriate exchange rate for converting the entire debt to dollars, he insisted that the current official exchange rate of $1.00 = £E 0.70 (a debt of $18.6 billion) would overstate the problem.

Lacking accurate Egyptian data, we believe Egypt's official medium- and long-term civilian and military debt at the end of 1982 totaled close to $24.5 billion. According to IMF estimates, Egypt's civilian debt was $18 billion or nearly three-fourths of the total.

The remainder of the debt is composed mainly of US FMS credits and Soviet military loans. US credits for military purchases under the FMS program totaled $2.1 billion in disbursed loans at the end of September 1982 and by the end of 1982 probably were close to $2.2 billion. The remaining military debt to the Soviet Union probably amounts to the equivalent of about $4.2 billion, but this figure is far from firm. This debt

Table 2
Egypt: Foreign Debt, December 1982 [a]

Billion US $

Civilian	18.0
US FMS	2.2
USSR military	4.2
China military	0.1
Total	**24.5**

[a] Estimated medium- and long-term debt. Excludes $3.5 billion in short-term debt of Egyptian public and private entities.

25X1

25X1

is not due in hard currency but can be repaid with Egyptian bilateral trade surpluses. In the spring of 1977, then Deputy Prime Minister Kaissouni publicly stated that Egypt's total debt to the Soviet Union was equivalent to $4.225 billion. Other official Egyptian statements in 1977 placed the civilian debt to the Soviet Union at $555 million, thereby making the military debt in 1977 $3.67 billion. Since payments have not been made on the military debt, the 2.5-percent interest charged on the loan would increase the amount outstanding to about $4.2 billion at the end of 1982.

25X1

25X1

Data provided to the US Embassy by the Central Bank of Egypt in late 1979 showed that Egypt was making payments to the USSR on the small civilian debt by means of a small bilateral trade surplus as late as July 1979, and there is no reason to suspect that such repayment subsequently stopped. Egypt has not been servicing the military debt since September 1977, however, following a unilateral moratorium on repayment declared by President Sadat. Although relations between Egypt and the Soviet Union are likely to improve in the coming months, the military

25X1

debt could be a potential source of sustained contention. A significant writeoff of the debt of the Soviets, however, would have a favorable impact on the Egyptians and could generate unfavorable comparisons with the United States. [redacted] 25X1

Continuing military purchases from France and China have the potential to increase Egypt's foreign debt significantly but have not yet done so. In 1982 Egypt and France agreed to a $1 billion arms purchase, reportedly at 8-percent interest with repayments over eight years. We do not know if Egypt has incurred any liability under this agreement so far. Purchases from China apparently are on a cash basis and therefore do not generate any medium- or long-term liability. Reporting from the US Embassy in Beijing, however, indicates that Cairo owes $100 million that is due in September 1983 and that China may have agreed to extend this payment for a year when Mubarak visited China this spring. [redacted] 25X1

In addition to medium- and long-term civilian and military debt, the Egyptian public and private sectors owe about $3.5 billion in short-term debt to foreign banks. Normally this figure is not included in estimates of total external debt, which takes into account only loans with original maturities of greater than one year. Our estimate is based on statistics from the Bank of International Settlements about loans from Western banks to Egyptian public- and private-sector borrowers. The estimate includes only loans with original maturities of one year or less. Most of the short-term debt is trade financing for public-sector banks and firms that is rolled over when foreign banks reconfirm new letters of credit as old ones are paid off. The US Embassy noted in January 1983 that, although foreign banks were not eager to make additional long-term loans to Egypt and many were trying to hold their short-term exposure to current levels, there were no indications that the banks were intending to reduce their short-term lending. In the event of a debt crisis, however, some banks might not be willing to roll over these loans, causing even more serious problems for Egypt. [redacted] 25X1